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No. 95-

In the Supreme Court of the United States

OCTOBER TERM, 1995

ORIGINAL APPALACHIAN ARTWORKS, INC.
Respondent,

v.

S. DIAMOND ASSOCIATES, INC.,
Petitioner.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

1. Should not the long-standing conflict among the circuits regarding the doctrine of judicial estoppel be resolved so that the doctrine is governed by independent federal law and applied uniformly in all cases in the federal courts, rather than be governed in some cases by state law and thus applied inconsistently, depending on whether the case is based on diversity or federal question jurisdiction?

PARTIES TO THE PROCEEDINGS

Petitioner is S. Diamond Associates, Inc. Pursuant to Supreme Court Rule 29.1, petitioner states that it has no parent or subsidiary company.

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No. 95-

In the Supreme Court of the United States

OCTOBER TERM, 1995

Original Appalachian Artworks, Inc.
Respondent,
v.
S. Diamond Associates, Inc.,
Petitioner.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, S. Diamond Associates, Inc., respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit, entered in this proceeding on January 25, 1995, affirming the judgment of the United States District Court for the Northern District of Georgia.

OPINIONS BELOW

The original action was tried in the United States District Court for the Northern District of Georgia, where federal jurisdiction was based on 28 U.S.C. §§ 1332, 2201 and 2202. On March 31, 1989, the district court granted summary judgment against defendant S. Diamond

Associates, Inc. (Diamond) disposing of all claims in the complaint and counterclaim. The district court's judgment was entered on April 5, 1989.

On September 19, 1990, the United States Court of Appeals for the Eleventh Circuit reversed the grant of summary judgment and remanded the case for trial. The Opinion of the Court of Appeals is reported at 911 F.2d 1548 (11th Cir. 1990) (App. 32a).[1]

Trial was held in this matter from June 24, 1993, through June 30, 1993, and judgment was entered on August 2, 1993, against Diamond, based on findings of fact, conclusions of law and an order dated July 30, 1993 (App. 16a). Diamond was denied all the relief it sought.

A different panel of the United States Court of Appeals for the Eleventh Circuit affirmed the judgment of the district court on January 25, 1995. The Opinion of the Court of Appeals is reported at 44 F.3d 925 (11th Cir. 1995) (App. 1a).

On July 24, 1995, the Court of Appeals denied Diamond's petition for rehearing (App. 14a).

JURISDICTION

This Petition for Writ of Certiorari to review the

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[1] The following abbreviations are used:

App.: Pages of the Appendix to this Petition

A: Appendix filed with the Eleventh Circuit Court of Appeals

R__-__: Trial transcript testimony indicated by the district court's volume and page numbers

judgment of the Court of Appeals For The Eleventh Circuit filed on January 25, 1995, is being filed within ninety (90) days of the Order of the Court of Appeals of July 24, 1995, denying the petition for rehearing.

The jurisdiction of this Court is based upon 28 U.S.C. §§ 1254(1) and 2101(c).

STATEMENT OF THE CASE

Important questions which involve a conflict among the circuits over the proper application of judicial estoppel arise in this case from an unlikely source: the Cabbage Patch Kids craze that swept the country ten years ago. Judicial estoppel is a common law doctrine used to preclude a party from abusing the judicial process by reversing or recanting sworn testimony that the party relied upon successfully in a prior case.

Plaintiff Original Appalachian Artworks, Inc. (OAA) owns the copyrights and trademarks for the Cabbage Patch Kids sculptured dolls that became a huge marketing success during the early 1980's (App. 2a, 33a). OAA licensed the Cabbage Patch Kids trademarks and copyrights to hundreds of companies in association with a wide variety of products, including an exclusive license to defendant S. Diamond Associates, Inc. (Diamond) for self-adhesive children's stickers (A2, 11-12) (App. 2a, 33a). In 1986, OAA sued Topps Chewing Gum Company (Topps) for infringement of the Cabbage Patch trademarks and copyrights when Topps marketed its infamous Garbage Pail Kids self-adhesive stickers (A23-24) (App. 3a-4a, 34a). OAA initially obtained a preliminary injunction against Topps and eventually settled the case for $7 million (App. 4a, 34a).

In this case, Diamond seeks a portion of the settlement proceeds that OAA obtained in the prior litigation against Topps (App. 4a-5a, 35a). To prove its injury in this case, Diamond relied on OAA's sworn testimony and admissions from OAA's prior litigation showing that Topps had damaged Diamond, as well as OAA (App. 7a, 10a). In the present case, however, OAA reversed its prior position that Topps had damaged Diamond in order to prevail here and defeat Diamond's claim for a portion of the Topps settlement (App. 7a-10a).

The decision in this case has allowed OAA to win twice on the basis of contradictory factual positions because the courts below refused to apply judicial estoppel and bind OAA to its sworn positions from its prior litigation that Topps had damaged Diamond. At least one court has been misled.

The Topps Litigation

From February 15, 1983 through January 31, 1987, Diamond was an exclusive licensee for self-adhesive children's stickers under the Cabbage Patch Kids trademarks and copyrights (A11-12) (App. 2a-3a, 33a). The trademarks and copyrights were licensed to Diamond by OAA's exclusive licensing agent, Schlaifer, Nance & Company (SNC) (A2).

In 1985, during the term of Diamond's exclusive license, Topps began to market the Garbage Pail Kids, a package of sticker cards with images of characters that infringed the Cabbage Patch Kids depicted in unflattering situations (A3) (App. 3a-4a, 34a). Prior to introducing the Garbage Pail Kids stickers in 1985, Topps sought a license from SNC and OAA for a Cabbage Patch Kids sticker

product; but, because of Diamond's exclusive sticker license, SNC and OAA declined to grant Topps the requested license (A23) (App. 34a, 42a). Topps then tried to obtain a sublicense for stickers from Diamond, but this was denied (A24). Thereafter, without the approval of SNC, OAA or Diamond, Topps introduced its highly successful — and infringing — Garbage Pail Kids stickers (A20).

On March 5, 1986, OAA instituted a suit against Topps, *Original Appalachian Artworks, Inc. v. Topps Chewing Gum Company,* 642 F.Supp. 1031 (N.D. Ga. 1986) (hereinafter *Topps*), alleging, among other things, that the Garbage Pail Kids stickers constituted copyright infringement, trademark infringement, unfair competition and dilution; that Topps' Garbage Pail Kids were marketed by Topps as an alternative to and caused actual confusion with Diamond's Cabbage Patch stickers; and that Topps' Garbage Pail Kids stickers would seriously interfere with the marketability of Cabbage Patch products, particularly Diamond's Cabbage Patch stickers, which competed directly against the Garbage Pail Kids stickers (A23-24) (App. 4a, 34a).

Other than the copyright registrations for the actual Cabbage Patch dolls and packaging, the only copyright registrations asserted by OAA in the *Topps* litigation were those obtained by Diamond, at its own expense, for the copyrights in its Cabbage Patch stickers (R14-605-06). And other than the manufacturer of Cabbage Patch dolls, Diamond was the only licensee specifically mentioned in OAA's complaint against Topps (R14-605-06).

OAA moved for a preliminary injunction in the *Topps* litigation and a hearing was held in June 1986 (App. 4a, 34a). OAA presented the testimony of its principal officers,

Xavier Roberts and Della Tolhurst, and its licensing agent, Roger Schlaifer, President of SNC, among others (App. 41a-42a).

Mr. Schlaifer testified at the *Topps* preliminary injunction hearing that Diamond's exclusive license covered the type of stickers that Topps marketed as Garbage Pail Kids stickers (A111-13) (App. 42a). He testified that Diamond had "an exclusive license for self-adhesive stickers of all kinds" covering "all self-adhesive stickers and sticker by products" and that Diamond's exclusive license precluded SNC from granting Topps a license for the Garbage Pail Kids type of stickers (A23-24, 111-13) (App. 42a).

Similarly, Xavier Roberts, creator of the Cabbage Patch Kids, testified that Garbage Pail Kids stickers were "going after the same market" as Diamond's Cabbage Patch stickers (A114). Mr. Schlaifer also testified in *Topps* that he believed Diamond's Cabbage Patch stickers and Topps' Garbage Pail Kids stickers "are competing products" (A111-13) (App. 42a). Della Tolhurst, president of OAA, testified that Topps' Garbage Pail stickers competed against Diamond's Cabbage Patch stickers (A109). OAA also submitted evidence of actual confusion between Topps' Garbage Pail Kids stickers and Diamond's Cabbage Patch stickers (A32).

OAA's sworn testimony that Topps' Garbage Pail Kids stickers damaged Diamond was central to OAA's preliminary injunction motion because it showed the harm caused by Topps to OAA and its licensee Diamond, and that the Garbage Pail Kids stickers were an infringement and not a fair use of the Cabbage Patch Kids trademarks and copyrights (App. 41a-42a). Indeed, OAA made a strong point in asserting these allegations, as the Eleventh Circuit

pointed out in the first panel's opinion in this case. *Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc.*, 911 F.2d 1548, 1552-53 (11th Cir. 1990) (App. 41a).

On August 29, 1986, the court in the *Topps* litigation held that OAA was entitled to a preliminary injunction. *Original Appalachian Artworks, Inc. v. Topps Chewing Gum, Inc.*, 642 F.Supp 1031 (N.D. Ga. 1986) (A3). The preliminary injunction never issued, however, because OAA failed to post the required bond, claiming it was financially unable to do so (R12-167-68) (App. 4a).

Trial on the merits in *Topps* began in January 1987 (A3). OAA intended to call Sidney Diamond and Yanni Marakis, President and Vice President of Diamond, to testify at trial about the damage caused by Topps' Garbage Pail Kids stickers, and both were listed as witnesses by OAA in the *Topps* pretrial order (R14-417). *See Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc.*, 911 F.2d 1548, 1553 (11th Cir. 1980) (App. 42a-43a). However, on February 2, 1987, after only three days of trial, the case was settled and thereafter dismissed pursuant to stipulation on February 4, 1987 (A3) (App. 34a). Topps paid OAA a total of $7 million to settle the case (A3) (App. 4a, 34a). Diamond was not informed of the settlement until after it was consummated.

Although Diamond had standing as an exclusive copyright and trademark licensee to bring an action against Topps for damages and Topps' profits under 17 U.S.C. § 501(b) and 15 U.S.C. § 1125(a), OAA expressly agreed (without Diamond's consent) as part of the settlement with Topps that it would not consent to its licensees, including Diamond, bringing suit against Topps (A3) (App. 4a, 34a-35a). Had Diamond sued Topps it could have

recovered Topps' profits or a reasonable royalty as a measure of damages for the infringement. This was the same theory of recovery that OAA pursued in the *Topps* case. By losing its right to sue Topps, Diamond was injured.

Thus, the end result of the *Topps* case is the same as if OAA had failed to take any action — Diamond was left without recourse against Topps and without compensation for the harm caused by Topps.

The Present Litigation

On February 3, 1987, immediately after Diamond learned of the settlement between OAA and Topps, it filed a motion to intervene in the *Topps* litigation for the purpose of asserting its interest in the settlement proceeds (A3) (App. 4a, 35a). In response to Diamond's motion to intervene, OAA filed the present declaratory judgment action on February 4, 1987, for a judgment that Diamond had no right to any portion of the Topps settlement proceeds (A3). In light of OAA's institution of the present case, the court in the *Topps* litigation denied Diamond's motion to intervene (A3) (App. 4a, 35a).

Diamond filed a counterclaim in the present case for, among other things, the imposition of an implied trust and/or equitable lien on the Topps settlement proceeds and an award of a portion of the Topps settlement proceeds to which Diamond claims it is entitled (A21) (App. 4a, 35a).

On July 31, 1987, Diamond filed a motion for partial summary judgment against OAA that OAA unlawfully interfered with Diamond's exclusive license rights and for the imposition of an implied trust or equitable lien in

Diamond's favor upon the Topps settlement proceeds (A21) (App. 5a, 35a-36a). OAA filed a cross motion for summary judgment on October 30, 1987, seeking a judgment that Diamond had no interest in the Topps settlement proceeds (A21) (App. 4a-5a, 35a).

On March 31, 1989, the district court granted OAA's motion for summary judgment and denied Diamond's motion (A19-24) (App. 4a-5a, 35a). Diamond appealed from that judgment and, on September 18, 1990, in its first opinion in this case, the Eleventh Circuit reversed the grant of summary judgment in favor of OAA and remanded the case to the district court. *Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc.*, 911 F.2d 1548 (11th Cir. 1990) (App. 32a). In this first opinion, the Eleventh Circuit found that:

> In bringing its infringement action against Topps, OAA heavily relied on the injury suffered by Diamond to support its claim for injunctive relief and damages. For example, OAA's proposed findings of fact and conclusions of law in the *Topps* case emphasizes throughout that Topps stickers directly competed with Diamond's stickers.

911 F.2d at 1552 (App. 41a).

Thus, in its first opinion in this case, the Eleventh Circuit applied judicial estoppel when it concluded:

> In effect, therefore, OAA has conceded that Diamond suffered injury as a result of the direct competition between Topps' stickers and Diamond's own stickers.

911 F.2d at 1553 (App. 43a).

On remand, the trial in this matter commenced on June 24, 1993, and ended June 30, 1993. At trial, Diamond claimed that it was entitled to a portion of the Topps settlement because Topps' activities constituted a misappropriation and infringement of Diamond's exclusive Cabbage Patch license rights. Diamond relied on OAA's sworn testimony and other evidence from the *Topps* case that Topps' Garbage Pail stickers competed directly against Diamond's licensed Cabbage Patch stickers and thereby damaged Diamond (A14, 23-24, 32, 109, 11-14) (App. 41a-42a).

Diamond asserted in this case that Topps' infringement appropriated Diamond's exclusive license and, therefore, was in effect a forced sublicense. In the prior *Topps* litigation, OAA asserted this very *same* theory of damages, that is, that Topps was a forced licensee of OAA (A91, 101).

In a judgment entered on August 2, 1993, based on findings of fact, conclusions of law and an order dated July 30, 1993, the district court held that Diamond was not entitled to any portion of the Topps settlement (App. 16a).

Diamond appealed from the district court's judgment of July 30, 1993, and a second panel of the Eleventh Circuit affirmed *per curiam* in an opinion filed January 25, 1995. 44 F.3d 925 (App. 1a). Both the district court and the Eleventh Circuit refused to apply judicial estoppel to bind OAA to the prior factual positions it had successfully asserted in the *Topps* case. Both courts allowed OAA to recant its prior positions from *Topps* and, accepting OAA's complete reversal, found that Topps had not

misappropriated Diamond's exclusive license rights or otherwise damaged Diamond. In making this finding, the district court and the Eleventh Circuit ignored OAA's sworn testimony and other evidence in the *Topps* case that Diamond suffered injury as a result of Topps' infringement (App. 1a-13a, 16a-31a).

By refusing to bind OAA to its prior sworn factual positions under the doctrine of judicial estoppel, the Eleventh Circuit has set a disturbing precedent which adversely reflects upon the federal judicial process. The results of this case undermine the integrity of the federal courts and have a significant impact beyond this case.

REASONS FOR GRANTING THE WRIT

This case presents an important issue for the federal judiciary as to the proper application of judicial estoppel. Although the doctrine of judicial estoppel is intended to protect the integrity of the courts and prevent litigants, like OAA, from playing "fast and loose" with the courts, the circuit courts of appeals are split as to its proper application in diversity cases.

Some courts have held that a federal court sitting in diversity jurisdiction is bound by controlling state law in applying judicial estoppel. According to such courts, if controlling state law does not recognize the doctrine, then judicial estoppel cannot be applied in a diversity case. Other courts have applied an independent federal common law doctrine of judicial estoppel regardless of whether a case is based on diversity or federal question jurisdiction. The specific requirements for the application of judicial estoppel are vague and vary from circuit to circuit.

Conflicting precedent has caused much confusion over the appropriate application and formulation of judicial estoppel. The Eleventh Circuit's refusal to apply judicial estoppel in this diversity case conflicts with decisions of the Fourth and Sixth Circuit Courts of Appeals.

Resolution of this issue has far-reaching significance for the federal courts and the bar. The public perception of the integrity of attorneys and the judicial system is, unfortunately, not high. By refusing to apply judicial estoppel to hold OAA and its attorneys accountable for the positions they successfully presented in prior litigation, the Eleventh Circuit helps promote the "negative image" of lawyers.

The conflict among the circuits and apparent confusion in establishing appropriate criteria for application of judicial estoppel arise from the lack of a clear understanding of the doctrine's nature and purpose. The Court should resolve this conflict and provide appropriate guidelines for the application of an independent and uniform federal doctrine of judicial estoppel. Otherwise, the value of judicial estoppel to protect the federal judicial process will be greatly diminished. Federal courts will be severely restricted in diversity cases, like the present one, to prevent abuse of the judicial process if constrained to rely on a state's recognition and formulation of the doctrine.

I. JUDICIAL ESTOPPEL ARISES FROM EQUITABLE CONSIDERATIONS WHICH SHOULD BE APPLIED AS AN INDEPENDENT DOCTRINE BY THE FEDERAL COURTS

Judicial estoppel is a common law doctrine closely related to equitable estoppel and collateral estoppel, but

dissimilar from the latter two doctrines in critical respects. *Konstantinidis v. Chen,* 626 F.2d 933, 936-37 (D.C. Cir. 1980); *Allen v. Zurich Ins. Co.*, 667 F.2d 1162, 1166-67 (4th Cir. 1982). Judicial estoppel also differs in significant respects from *res judicata*. Mark J. Plumer, Note, *Judicial Estoppel: The Refurbishing of a Judicial Shield,* 55 Geo. Wash. L. Rev. 409, 414 (1987).

The doctrine seems to have developed in the Tennessee state courts, *Parkinson v. California Co.*, 233 F.2d 432, 437-38 (10th Cir. 1956), and has been applied in varying degrees and formulations by the federal courts. *See, Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1261 (11th Cir. 1988); *Astor Chauffeured Limousine Co. v. Runnfeldt Inv. Corp.* 910 F.2d 1540, 1548 (7th Cir. 1990); *Bates v. Long Island R. Co.*, 997 F.2d 1028, 1037-38 (2nd Cir.), *cert. denied*, 114 S.Ct. 550 (1993); *Monterey Dev. Corp. v. Lawyer's Title Ins. Corp.*, 4 F.3d 605, 608-09 (8th Cir. 1993); *Patriot Cinemas, Inc. v. General Cinema Corp.*, 834 F.2d 208, 211-15 (1st Cir. 1987); *Allen v. Zurich Ins. Co.*, 667 F.2d 1162, 1166-68 (4th Cir. 1982); *Garcia v. Andrus*, 692 F.2d 89, 94 (9th Cir. 1982); *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1215 (9th Cir. 1984), *cert. denied,* 469 U.S. 1197 (1985); *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 598-99 (6th Cir. 1982); *Smith v. Montgomery Ward & Co.*, 388 F.2d 291 (6th Cir.), *cert. denied,* 393 U.S. 871 (1968); *Scarano v. Central R. Co.*, 203 F.2d 510, 512-14 (3d Cir. 1953); *In re Southwestern Bell Tel. Co.*, 535 F.2d 859 (5th Cir.), *modified*, 542 F.2d 297 (5th Cir. 1976), *rev'd on other grounds sub nom., Gravitt v. Southwestern Bell Tel. Co.*, 430 U.S. 723 (1977); *United States v. 49.01 Acres of Land*, 802 F.2d 387, 390 (10th Cir. 1986); *Parkinson v. California Co.*, 233 F.2d 432, 437-38 (10th Cir. 1956); *Water Technologies Corp. v. Calco, Ltd.*, 850 F.2d 660, 665-66 (Fed. Cir.), *cert. denied,* 488 U.S. 968 (1988); *Konstantinidis v. Chen*, 626 F.2d 933, 938 (D.C. Cir. 1980).

While no single formulation of judicial estoppel has appeared to gain widespread acceptance, one commentator has articulated a well-reasoned and straightforward definition:

> Judicial estoppel should bar the introduction of a party's factual assertions to a court when these assertions are inconsistent with some other version of the facts that inured to the party's benefit in some other judicial proceeding.
>
> * * *
>
> Judicial estoppel merely requires a court to find that a party is attempting to reverse the facts sworn to in an earlier adjudication in which the party was successful.

Mark J. Plumer, Note, *Judicial Estoppel: The Refurbishing of a Judicial Shield,* 55 Geo. Wash. L. Rev. 409, 409, 416 (1987).

The Supreme Court long ago recognized this principle in *Davis v. Wakelee*, 156 U.S. 680, 689 (1895), when it declared:

> It may be laid down as a general proposition that, where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position . . .

Allowing a litigant such as OAA to play "fast and loose with the courts" is an "evil" the courts should not tolerate because it is an affront to judicial dignity. *Scarano*

v. Central R. Co., 203 F.2d 510, 513 (3d Cir. 1953). OAA has successfully thwarted the function of judicial estoppel:

> The essential function of judicial estoppel is to prevent intentional inconsistency; the object of the rule is to protect the judiciary, as an institution, from the perversion of judicial machinery.
>
> * * *
>
> Judicial estoppel addresses the incongruity of allowing a party to assert a position in one tribunal and the opposite in another tribunal. If the second tribunal adopted the party's inconsistent position, then at least one court has probably been misled.

Edwards v. Aetna Life Ins. Co., 690 F.2d 595, 599 (6th Cir. 1982).

In sum, the objective of judicial estoppel is to preclude a party from reversing or recanting sworn testimony that the party previously asserted successfully in a prior proceeding. This simple and straightforward policy is essential to the proper functioning of the federal courts and should be a central tenet in all litigation in the federal courts, regardless of whether a case is based on diversity or federal question jurisdiction.

II. THE ELEVENTH CIRCUIT'S DECISION CONFLICTS WITH DECISIONS OF THE FOURTH AND SIXTH CIRCUITS

In diversity cases, the federal courts are in disagreement on whether they are controlled by state law

in applying judicial estoppel. The Eleventh Circuit in this case has aligned itself with the District of Columbia, Fifth, Eighth, Ninth and Tenth Circuits in holding that the application of judicial estoppel is governed by state law in a diversity case (App. 10a). The court below has sided against the Fourth and Sixth Circuits which apply an independent federal doctrine of judicial estoppel in diversity, as well as federal question cases. [2]

The six circuits (including the Eleventh Circuit) which have held that federal courts are bound in diversity cases by state law first determine whether applicable state law recognizes the doctrine and, if so, then apply the controlling state law formulation. These circuits apparently believe that judicial estoppel is a substantive rule of law. *Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc.*, 44 F.3d 925, 930 (11th Cir. 1995); *Konstantinidis v. Chen*, 626 F.2d 933, 937 (D.C. Cir. 1980); *Monterey Dev. Corp. v. Lawyer's Title Ins. Corp.*, 4 F.3d 605, 608-09 (8th Cir. 1993); *In re Osborn*, 24 F.3d 1199, 1207 n.11 (10th Cir. 1994); *Walker v. American Motorists Ins. Co.*, 529 F.2d 1163, 1164-65 (5th Cir. 1976); *Sholly v. Annan*, 450 F.2d 74, 76, n.4 (9th Cir. 1971).

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[2] The Eleventh Circuit also apparently disagrees with the Sixth Circuit on the applicability of judicial estoppel if a final decision on the merits was not obtained in the prior litigation. In dicta, the court below questioned application of judicial estoppel here because the *Topps* litigation ended in settlement. 44 F.3d at 930 (App. 11a). However, judicial estoppel should apply against OAA in the present case regardless of the final disposition of the *Topps* litigation. OAA's success in obtaining a preliminary injunction against Topps creates a judicial estoppel in this case and precludes OAA from changing its positions on issues that were relevant to the grant of the preliminary injunction. *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 599 n.5 (6th Cir. 1982).

However, the Fourth and Sixth Circuits hold that federal courts should apply an independent federal doctrine of judicial estoppel in diversity cases and are not controlled by a state's formulation of the doctrine because it is a procedural rule that relates to the protection of the federal judiciary. "The question primarily concerns federal interests, and, consequently, federal courts must be free to develop principles that most adequately serve their institutional interests." *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 598 n.4 (6th Cir. 1982).

This Court should take this opportunity to resolve this conflict among the circuits and provide needed clarification on the proper application of judicial estoppel in federal court. The different formulations of judicial estoppel that have been applied by the federal courts greatly undermine its effectiveness to protect the federal judicial system from abuse.

III. DIVERSITY JURISDICTION SHOULD NOT CONTROL APPLICATION OF JUDICIAL ESTOPPEL

The courts below in this case lost sight of the important policies underlying judicial estoppel in failing to hold OAA accountable for its prior sworn factual assertions in the *Topps* case. The decision in this case sends the wrong signal to parties and their counsel in federal courts that "facts" can be changed as they may suit a party's purpose. The results of this case where OAA prevailed twice on contradictory factual positions should not be sanctioned. That this is a diversity case should not have played any role in the application of an independent federal doctrine of judicial estoppel.

Although the Eleventh Circuit has recognized and applied an independent federal doctrine of judicial estoppel "where federal issues are involved," *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1261 (11th Cir. 1988), it did not apply judicial estoppel in this diversity case because it believed that this issue was controlled by state law (App. 10a). If the present case had been based on federal question jurisdiction, the court below would have looked "to common law or to the policies supporting the doctrine itself for guidance in establishing an appropriate formulation" *Id.*, and reached an opposite result.

The result of the present case undermines the policy interests of the judicial estoppel doctrine, as expressed by the Eleventh Circuit itself:

> The policy interests are simply stated by the doctrine itself. The doctrine of judicial estoppel "is directed against those who would attempt to manipulate the court system through the calculated assertion of divergent sworn positions in judicial proceedings." *Johnson Service Co. v. Transamerica Insurance Co.*, 485 F.2d 164, 174 (5th Cir. 1973).

Id.

Yet, the Eleventh Circuit paid no attention to these important policies underlying judicial estoppel in this case because "Georgia courts have not expressly sanctioned" judicial estoppel (App. 10a). OAA was allowed to contradict its prior sworn testimony successfully asserted in the *Topps* case in order to prevail in this case. *Original Appalachian Artworks v. S. Diamond Assocs.*, 44 F.3d 925, 929-30 (11th Cir. 1995) (App. 10a-11a). This makes no sense. The

objectives of judicial estoppel should apply with equal force in both diversity and federal question cases.

As the court in *Allen v. Zurich Ins. Co.*, 667 F.2d 1162, 1167-68, n.4 (4th Cir. 1982), reasoned:

> Although this is a diversity case, we consider that federal law controls the application of judicial estoppel, since it relates to protection of the integrity of the federal judicial process. We think that neither 28 U.S.C. § 1738, the full faith and credit statute, nor *Erie R.R. v. Tompkins,* 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938), requires inquiry into the possible existence of a conflicting state rule.

Allen, 667 F.2d at 1167-68 n.4.

The doctrine of judicial estoppel should not be controlled by a host of state laws, which may vary greatly from jurisdiction to jurisdiction. The "object of the rule is to protect the judiciary, as an institution, from the perversion of judicial machinery." *Edwards v. Aetna Life Ins. Co.,* 690 F.2d 595, 599 (6th Cir. 1982). As such, the federal courts are not required, under *Erie R.R. v. Tompkins,* 304 U.S. 64 (1938), to determine whether there exist possibly conflicting state rules.

The conflict among the circuits on this point appears to arise from inconsistent interpretations of *Byrd v. Blue Ridge Rural Electric Cooperative, Inc.,* 356 U.S. 525 (1958), and *Hanna v. Plumer,* 380 U.S. 460 (1965).

In *Byrd*, the Court recognized that the outcome determination test of *Guaranty Trust Co. v. York,* 326 U.S. 99 (1945), was too broad, and that important policies of the

federal courts must also be taken into account. 356 U.S. at 536-38. The *Byrd* Court balanced the importance of the state's interest and the federal court's countervailing interests. *Id.* at 535-40.

Under the *Byrd* balancing test judicial estoppel should be viewed as a procedural rule to be applied as an independent federal doctrine. Judicial estoppel is "not a rule intended to be bound up with the definition of the rights and obligations of the parties." *Id.* at 536. Rather, it is intended to protect the integrity of the federal judicial system and prevent abuse of that system by litigants like OAA. The court's, rather than the parties', rights are paramount.

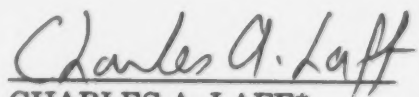
In the present case, *Hanna* does not require a different result from *Byrd*. The *Hanna* Court concluded that the outcome determination test of *Guaranty Trust* was too mechanical and would emasculate the ability of federal courts to regulate their own procedures. 380 U.S. at 467-68. An independent federal doctrine of judicial estoppel is exactly the type of rule that most readily enables a federal court to regulate its own procedures and, therefore, should be applied, whether a case is based upon diversity or federal question jurisdiction.

In the present case, OAA should have been precluded from denying its sworn testimony in *Topps* that: (1) Diamond's license was exclusive for all sticker products; (2) Diamond's Cabbage Patch Kids stickers and Garbage Pail Kids stickers competed directly in the marketplace; and (3) Topps' Garbage Pail Kids stickers damaged Diamond and constituted a misappropriation of Diamond's exclusive license rights (App. 41a-42a).

OAA's intentional self-contradiction in this case is a gross manipulation of the judicial system and should not have been allowed merely because the case is based on diversity jurisdiction. Because the proper application of judicial estoppel in the federal courts has important ramifications beyond this case, it should be addressed by this Court.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.



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APPENDIX

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 93-9077

D.C. Docket No. 1:87-CV-183-JTC

ORIGINAL APPALACHIAN ARTWORKS, INC., a Georgia Corporation,

Plaintiff-Counter-Defendant, Appellee,

SCHLAIFER NANCE & COMPANY, INC.,

Intervenor-Plaintiff,

versus

S. DIAMOND ASSOCIATES, INC., an Illinois Corporation,

Defendant-Counter-Claimant, Appellant.

Appeal from the United States District Court
for the Northern District of Georgia

(January 25, 1995)

Before EDMONDSON and CARNES, Circuit Judges, and HENDERSON, Senior Circuit Judge.

PER CURIAM:

S. Diamond Associates, Inc. ("Diamond") appeals from the judgement of the United States District Court for the Northern District of Georgia in this action brought by Original Appalachian Artworks, Inc. ("OAA") seeking a declaratory judgment that Diamond was not entitled to recover a portion of the proceeds of a settlement agreement

made between OAA and Topps Chewing Gum, Inc. ("Topps"). For the reasons set forth below, we affirm.

I. BACKGROUND

This is the second appearance of this case in our court after an earlier remand to the district court. *See Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc.*, 911 F.2d 1548 (11th Cir. 1990) ("*OAA I*"). The relevant facts are as follows.

OAA owns the copyright registration and trademark for the Cabbage Patch Kids, soft sculptures designed by Xavier Roberts, which made their debut in 1980 as the "Little People from Babyland General." OAA's principal licensee, Coleco Industries, began mass marketing Cabbage Patch Kids dolls in 1983.[1] Also in 1983, OAA entered into a licensing agreement with Diamond through OAA's exclusive licensing agent, Schlaifer Nance & Co., Inc., to manufacture and sell certain puffy sticker products related to its dolls.[2] The contract gave Diamond an " exclusive license to utilize the name, character, symbol, design, likeness and visual representation" of Cabbage Patch Kids, "solely and only in

[1] OAA's president, Della Tolhurst, testified at the trial in this case that the sculptures were never referred to as dolls within OAA, but a "kids" or "babies." (R12-76). She described the "Little People" as "unique individuals, very huggable, soft, lovable, very wholesome products." (*Id.*). The Cabbage Patch Kids manufactured and marketed by Coleco Industries were mass-produced in the Far East, had vinyl heads and initially carried a wholesale price of $18.00. OAA continued to make and distribute hand stitched "dolls" with fabric heads, which sold in the gift market for $125.00 or more. Both products came with birth certificates and adoption papers. (*Id.* at 80).

[2] Tolhurst testified that at the height of the Cabbage Patch Kids' popularity, OAA had approximately 127 licensees who marketed hundreds of different related products. (R12-84).

connection with the manufacture, distribution and sale of the article or articl[es] specified in Schedule 'B.'" (Plaintiff's Trial Exhibit 1 ¶ 1). Schedule "B" stated:

Schedule "B" *LICENSED PRODUCTS*

1. Self adhesive character and/or logo stickers as follows . . .
   ACCESSORIES MAY BE INCLUDED THAT DO NOT CONFLICT WITH COLOR FORMS.
   a. puffy vinyl stickers
   b. "color-me" fuzzy stickers with accessory markers
   c. puffy, scratch 'n sniff stickers
   d. flat, scratch 'n sniff stickers on cards or rolls
2. Waxed-paged sticker collection book
3. Waxed-page sticker baby book in book form.

(*Id.* at Schedule "B"). Under the terms of the agreement, OAA retained exclusive rights to the goodwill associated with the Cabbage Patch name. (*Id.* at ¶ 11). The contract also reserved for OAA "the sole right to determine whether or not any action shall be taken on account of any infringements or imitations" of the licensed products and prohibited Diamond from taking any such action without first obtaining OAA's written consent. (*Id.* at ¶ 7(a)).

In 1985, Topps began distributing a sticker type of bubble gum trading card under a trademark it obtained for Garbage Pail Kids. *See Original Appalachian Artworks, Inc. v. Topps Chewing Gum, Inc.*, 642 F.Supp. 1031, 1032

(N.D. Ga. 1986) ("*Topps*"). The stickers "derisively depict dolls with features similar to Cabbage Patch Kids dolls in rude, violent and frequently noxious settings." *Id.*; *see also OAA I,* 911 F.2d at 1549 (describing Garbage Pail Kids as "strikingly similar to the Cabbage Patch Kids, but depicted in less than flattering situations"). In response, OAA filed a lawsuit against Topps for copyright and trademark infringement and unfair competition, in which it successfully sought the right to a preliminary injunction against Topps. *See Topps, supra.*[3] Later, in settlement of the litigation, Topps agreed to pay OAA seven million dollars in damages. In return, OAA agreed that it would not authorize any of its licensees, including Diamond, to sue Topps for copyright or trademark infringement connected with the Garbage Pail Kids. After learning of the settlement, but prior to the dismissal of the case, Diamond moved to intervene on the ground that it too had suffered damages from Topps' conduct. The district court denied Diamond's motion. *See OAA I,* 911 F.2d at 1549.

OAA subsequently filed this action founded upon diversity of citizenship, 28 U.S.C. § 1332, seeking a declaratory judgment that Diamond had no right to share in the settlement proceeds. Diamond filed a counterclaim, alleging that it suffered economic injury from the marketing of the Garbage Pail Kids cards and that OAA had a fiduciary duty under its licensing agreement with Diamond to protect Diamond's interests as a licensee. Diamond sought to have the court impose a constructive or resulting trust or an equitable lien on the settlement funds for an accounting to

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[3] Although OAA prevailed on its motion for a preliminary injunction, an injunction never issued because OAA did not make the necessary application. OAA states in its brief on appeal that it could not post the anticipated multi-million dollar bond required and instead, it asked for an expedited trial on the merits.

determine the amount of the damages to which it was entitled. Both parties moved for summary judgment. The district court granted judgment to OAA holding that (1) Diamond had no right to compensation under the licensing agreement because the contract reserved to OAA the exclusive right of suing infringers; and (2) OAA's settlement with Topps constituted a recovery solely for the damage caused to the goodwill associated with the Cabbage Patch Kids name, which was the sole property of OAA, and did not reflect any decrease in licensing revenues received from Diamond as a result of the marketing of Garbage Pail Kids (i.e., it did not diminish Diamond's sales). (R5-90 at 7-10); *see also OAA I,* 911 F.2d at 1550.

Diamond appealed. A panel of this court reversed, finding that Diamond had two possible grounds for recovering a portion of the settlement proceeds which the district court failed to consider. First, Diamond could recover the amount that represented "damages for Topps' appropriation of Diamond's exclusive license." *OAA I,* 911 F.2d at 1552. The court observed that "Diamond's licensing agreement expressly gave it the exclusive right to manufacture Cabbage Patch stickers. If, in marketing its Garbage Pail Kids stickers, Topps appropriated Diamond's exclusive license to manufacture stickers, then Diamond is entitled to the proportion of the settlement representing that appropriation." *Id.*. Second, Diamond could recover

> the proportion of the settlement representing Diamond's injuries as a result of Topps' sales, even if that injury did not relate to a right that the licensing agreement expressly granted to Diamond. OAA has a fiduciary obligation not to allow its own copyright to be used to the detriment of its licensees. Thus, if Diamond was injured by Topps' conduct--even if that conduct did not constitute an appropriation of Diamond's

> exclusive license--Diamond is entitled to the proportion of the settlement representing that injury. *The present case, therefore, turns on a single issue: did Diamond suffer injury as a result of Topps' conduct? If so, Diamond is entitled to a proportion of the settlement whether or not Topps' conduct constituted an appropriation of Diamond's exclusive license.*

Id. (emphasis added).

The panel also held that the district court's grant of summary judgment to OAA could not be affirmed on the alternative basis that there was no genuine issue of material fact with respect to whether Diamond had been injured by Topps' conduct. *Id.* The court stated that

> [i]n bringing its infringement action against Topps, OAA heavily relied on the injury suffered by Diamond to support its claim for injunctive relief and damages. For example, OAA's proposed findings of fact and conclusions of law in the *Topps* case emphasizes throughout that Topps stickers directly competed with Diamond's stickers. As the transcript of the preliminary injunction hearing also demonstrates, OAA based its case in large part on the similarity between the Topps and Diamond stickers. Additionally, OAA had begun to prepare Diamond's owner to testify at trial in the *Topps* case regarding the company's injuries. In effect, therefore, OAA has conceded that Diamond suffered injury as a result of the direct competition between Topps' stickers and Diamond's own stickers. At the very least, that concession raises a genuine issue of material fact.

Id. at 1552-53 (footnotes omitted); *see also id.* at 1552 n.4 and 1553 n.5.

The case was therefore remanded to the district court to determine "whether, and to what extent, Diamond suffered injury as a result of Topps' conduct." *Id.* at 1553.

On remand, the district court conducted a bench trial. In its findings of fact and conclusions of law, it first considered the scope of Diamond's exclusive license. The court found that the licensing agreement unambiguously granted to Diamond the exclusive right to market the items listed in Schedule "B"; thus, Diamond's license extended only to the specific types of stickers listed in Schedule "B" rather than to the whole category of stickers. The court noted that even if the contract were ambiguous it would still conclude, on the basis of the evidence demonstrating the parties' intent, that Diamond had only a limited item license which did not extend to the type of bubble gum trading card stickers marketed by Topps. Consequently, the court ruled that Topps did not appropriate Diamond's exclusive license.

In accordance with this court's directive, the district court then determined whether Diamond had been damaged even though Topps' conduct did not constitute an appropriation of Diamond's license. In its consideration of this issue, the court found that Diamond failed to carry its burden of proof and that the evidence introduced at the trial demonstrated there was no direct competition between Topps' Garbage Pail Kids stickers and Diamond's Cabbage Patch Kids stickers. The court rejected Diamond's reliance on the position take by OAA in the *Topps* case as proof that it had been damaged. The court stated that OAA's proposed findings of fact and conclusion of law submitted at the preliminary injunction stage of that litigation

were based on limited discovery and reflected positions taken by counsel at that time rather than facts supported by the evidence. According to Mr. Nodine, OAA's counsel in the *Topps* case, the [proposed] findings of fact and conclusions of law demonstrated counsel's positions at the time, many of which were later abandoned based on further discovery and counsel's evaluation of evidence that could not be proven at trial. Thus, the testimony of Roger Schlaifer [OAA's licensing agent] and the proposed findings of fact and conclusions of law at the preliminary injunction hearing must be given the weight the circumstances justify. The court notes that with regard to Mr. Schlaifer, the parties failed to call him as a witness in this case, and they did not refer to any deposition taken of Mr. Schlaifer in this case. Instead, the parties referred to Mr. Schlaifer's previous testimony in the transcript of the *Topps* preliminary injunction proceeding.

. . . .

. . . The arguments of counsel during the preliminary stages of the *Topps* case were taken for purposes of advocacy and, as Mr. Nodine testified in this case, OAA was unable to support this position with evidence. Although Mr. Nodine admits that he received an affidavit of Mr. Eber of Hallmark for the *Topps* case to the effect that the stickers competed, this was the only evidence of competition between Garbage Pail Kids and puffy vinyl stickers that OAA had in that case. Mr. Nodine testified during this trial that as a result of this lack of evidence of direct competition OAA changed the trial strategy in the *Topps* case to represent the

> damage that the Garbage Pail Kids had on OAA's good will and the Cabbage Patch Kids' image. Thus, Mr. Nodine testified that OAA's position at the preliminary stages of the *Topps* case became untenable, and the emphasis of the *Topps* litigation was changed to focus on the damage to OAA's good will. The great weight of the evidence at this trial has shown that there was no direct competition.

(R9-150 at 9-10, 13-14).

After summarizing the evidence introduced at the trial relating to the sticker market in general, the demand for Cabbage Patch Kids products versus Garbage Pail Kids products and Diamond's sales during the relevant period of time, the court concluded that Diamond failed to show any injury as a result of Topps' conduct.[4] The court additionally found that Diamond failed to prove a breach by OAA of any fiduciary duty it owed to Diamond. Finally, the court noted that, even if Diamond had proven injury, "it offered no method to quantify that injury or to determine what proportion of the settlement was attributable to that injury." (*Id.* at 16 n.7). The court again entered judgment in favor of OAA.

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[4] Licensing expert Jerrold Robinson testified that the puffy vinyl sticker "craze" was fading in the latter part of 1984 and that by late 1985 (when Topps began selling Garbage Pail Kids trading cards), the market for this type of sticker was completely gone. (R13-332-33). This trend was reflected by Diamond's puffy sticker sales, which dropped dramatically in the fourth quarter of 1984. (*See* R12-114; Plaintiff's Trial Exhibit 19). There was also evidence that Diamond's stickers did not compete with Topps' stickers because the products had different channels of trade, prices and end uses. In addition, there was testimony that Cabbage Patch Kids appealed to younger girls, while the hard images portrayed by the Garbage Pail Kids attracted older boys.

II. DISCUSSION

Diamond's principal argument on appeal is that OAA should be held, under the doctrine of judicial estoppel, to the position it took in the *Topps* litigation that Topps' Garbage Pail Kids trading cards competed with Diamond's Cabbage Patch Kids stickers and that Diamond was damaged by Topps' sales. "The doctrine of judicial estoppel 'is directed against those who would attempt to manipulate the court system through the calculated assertion of divergent sworn positions in judicial proceedings.'" *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1261 (11th Cir. 1988) (quoting *Johnson Serv. Co. v. Transamerica Ins. Co.*, 485 F.2d 164, 175 (5th Cir. 1973)). "The doctrine is designed to prevent parties from making a mockery of justice by inconsistent pleadings." *American Nat'l Bank of Jacksonville v. FDIC*, 710 F.2d 1528, 1536 (11th Cir. 1983). We find Diamond's reliance on this concept to be unavailing for several reasons.

Because this is a diversity case, the application of the doctrine of judicial estoppel is governed by state law. *Chrysler Credit Corp.*, 842 F.2d at 1261; *City of Miami Beach v. Smith*, 551 F.2d 1370, 1377 n.12 (5th Cir. 1977). Diamond has not cited any Georgia law in support of its contention that the doctrine has relevance here. It appears from our independent research that the Georgia courts have not expressly sanctioned this method of issue preclusion. *See, e.g., Southmark Corp. v. Trotter, Smith & Jacobs*, 442 S.E. 2d 265, 266 (Ga. App. 1994) (cautioning "as to the semantical dangers which surround the term 'judicial estoppel' and similar matters of issue preclusion" and stating that the federal common law concept of judicial estoppel used to preclude a party from asserting a position inconsistent with one successfully maintained in a prior judicial proceeding

"has no exact equivalent under Georgia law"), *cert. denied*, 1994 Ga. LEXIS 702 (Ga. May 5, 1994). It is even less certain that the Georgia courts would embrace this notion under the particular facts of this case in which the prior proceeding ended in a settlement. *See Konstantinidis v. Chen*, 626 F.2d 933, 939 (D.C. Cir. 1980) (declining to apply judicial estoppel under District of Columbia law because "[a] settlement neither requires nor implies any judicial endorsement of either party's claims or theories").

We need not decide, however, whether OAA should be judicially estopped from denying that Diamond was damaged by Topps' conduct. The burden was on Diamond to prove how and to what extent it was injured by Topps' distribution of the Garbage Pail Kids stickers. Diamond could do this by (1) showing that Topps appropriated its exclusive license, or (2) establishing that it was harmed by Topps's activities even absent such appropriation. Diamond failed on both counts.

We find no error in the district court's determination that the licensing agreement between Diamond and OAA extended only to those items listed in Schedule "B" and that Topps, on account of this, did not invade Diamond's exclusive domain. In Georgia,

> [t]he cardinal rule in the construction of contracts is to ascertain the intention of the parties. The language which the parties have used will be looked to for the purpose of finding that intention, which when it is once ascertained *will prevail over all other considerations*, in determining the nature of the agreement. The question remaining is whether (the language) of the contract creates an ambiguity which may be explained by parol

> [evidence]. A word or phrase is ambiguous when it is of uncertain meaning and may be fairly understood in more ways than one. *Language which is unambiguous will not be construed as ambiguous based on extrinsic circumstances.* Where the language of a contract is plain and unambiguous, no construction is required or permissible and the terms of the contract must be given an interpretation of ordinary significance.

Race, Inc. v. Wade Leasing, Inc., 411 S.E. 2d 56, 57 (Ga. App. 1991) (quotation marks and citations omitted) (parentheses and emphasis in the original).

The agreement here plainly states that Diamond's license covers the articles specified in Schedule "B." Schedule "B" lists four types of stickers and two types of sticker books, neither of which encompass the sticker type of bubble gum trading card marketed by Topps. In view of the contract's unambiguous terminology, Diamond's contentions regarding the parties' course of dealings are irrelevant.

Because there was no invasion of Diamond's exclusive license, it could recover a portion of the settlement proceeds only by showing actual injury unrelated to appropriation as a result of Topps' activities. To do so, it necessarily was required to show some relationship between the distribution of Topps' Garbage Pail Kids stickers and lost sales of its Cabbage Patch Kids products. The district court's conclusion that there was no such correlation is a finding of fact subject to the clearly erroneous standard of review. *Taylor Rental Corp. v. J.I. Case Co.*, 749 F.2d 1526, 1530 (11th Cir. 1985) (appellate court reviews district court's determination of damages for clear error).

The only evidence Diamond proffered on the subject of damages was the testimony of Weston Anson, an expert in the licensing industry. He postulated that Topps distributed the Garbage Pail Kids merchandise pursuant to a de facto sublicense of Diamond's exclusive license covering the whole category of stickers. He contended, therefore, that Diamond was entitled to sublicensing royalties, which he stated are generally split equally between the licensor and the licensee. This theory of damages is completely dependent upon a finding that Diamond's license extended to the entire category of stickers, which we have determined was not the case. Diamond produce *no* evidence of actual harm. The district court's finding on the issue of damages is not clearly erroneous.

III. CONCLUSION

For the reasons stated herein, we hold that the district court did not err in deciding the merits of this case favorably to OAA and, accordingly, AFFIRM the court's judgment.

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 93-9077

ORIGINAL APPALACHIAN ARTWORKS, INC., a Georgia Corporation,

Plaintiff-Counter-Defendant, Appellee,

SCHLAIFER NANCE & COMPANY, INC.,

Intervenor-Plaintiff,

versus

S. DIAMOND ASSOCIATES, INC., an Illinois Corporation,

Defendant-Counter-Claimant, Appellant.

On Appeal from the United States District Court for the Northern District of Georgia

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(July 24, 1995)
ON PETITION(S) FOR REHEARING AND SUGGESTION(S) OF REHEARING EN BANC

Before: EDMONDSON and CARNES, Circuit Judges, and HENDERSON, Senior Circuit Judge.

PER CURIAM:

(X) The Petition(s) for Rehearing are DENIED and no member of this panel nor other Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of

Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing En Banc are DENIED.

( ) The Petition(s) for Rehearing are DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing En Banc are also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

_____

J.L. Edmondson
UNITED STATES CIRCUIT JUDGE

IN THE
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

Original Appalachian Artworks, Inc.,
Plaintiff,

v.

S. Diamond Associates, Inc., an Illinois Corporation,
Defendant.

Civil Action File No. 1:87-CV-183-JTC

ORDER OF COURT

FINDINGS OF FACT AND CONCLUSIONS OF LAW

I. *Eleventh Circuit Court of Appeals Decision*

Original Appalachian Artworks ("OAA") brought this declaratory judgement action against S. Diamond Associates, Inc. ("Diamond"), an exclusive licensee, to determine whether Diamond had a right to a proportion of OAA's settlement in a lawsuit against a third party for copyright infringement.

In February, 1983, OAA, through its exclusive licensing agent, Schlaifer, Nance & Company, entered into a licensing agreement with Diamond. OAA, as the owner of the copyright and trademark for the Cabbage Patch Kids, gave Diamond the "exclusive license to utilize the name, character, symbol, design, likeness and visual representation" of the Cabbage Patch Kids "solely and only in connection with the manufacture, distribution and sale of the article or articles specified in Schedule 'B'" of the

license agreement.

In 1985, Topps Chewing Gum, Inc. ("Topps") began to market the Garbage Pail Kids which was a package of sticker cards with images of characters that were similar to the Cabbage Patch Kids, but were depicted in less than flattering situations. In March, 1986, OAA brought suit in district court against Topps for copyright infringement, trademark infringement and unfair competition. In August, 1986, the district court granted OAA a preliminary injunction enjoining Topps from selling the Garbage Pail sticker products. *See Original Appalachian Artworks, Inc. v. Topps Chewing Gum, Inc.*, 642 F.Supp. 1031 (N.D.Ga. 1986) ("*Topps* case").[1] On February 2, 1987, OAA and Topps entered into a settlement agreement, wherein Topps agreed to pay OAA $7 million. In return, OAA agreed not to sue Topps and not to authorize any of its licensees to sue Topps for any copyright or trademark infringement related to the Garbage Pail Kids.

On February 4, 1987, after learning of the settlement agreement between Topps and OAA, Diamond moved to intervene in that case, alleging that it had suffered injury as a result of Topps' infringing conduct. The district court denied Diamond's motion to intervene. Subsequently, OAA brought the present declaratory judgment action against Diamond.

In an order entered in March, 1989, this court granted summary judgment in favor of OAA. On appeal, Diamond argued that the district court erred in holding that the licensing agreement prevented Diamond from recovering the proportion of the Topps' settlement reflecting

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[1] The court acknowledges that this injunction was never entered.

the injuries Diamond suffered as a result of Topps' conduct. Diamond also argued that the court erred in ruling that OAA had no fiduciary duty to pay Diamond a proportion of the settlement. The Eleventh Circuit Court of Appeals agreed with Daimond and remanded the case to this court for further proceedings. *See Original Appalachian Artworks v. S. Diamond Associates*, 911 F.2d 1548 (11th Cir. 1990).

In its decision the Eleventh Circuit Court of Appeals ruled that "Diamond is entitled to the proportion of the settlement that represents damages for Topps' appropriation of Diamond's exclusive license." *Id.* at 1551-52. Thus, the court held, "[i]f, in marketing its Garbage Pail stickers, Topps appropriated Diamond's exclusive license to manufacture stickers, then Diamond is entitled to the proportion of the settlement representing that appropriation. *Id.* at 1552. Furthermore, "Diamond is entitled to the proportion of the settlement representing Diamond's injuries as a result of Topps' sales, even if that injury did not relate to a right that the licensing agreement expressly granted to Diamond." *Id.* The court ruled that OAA has a fiduciary obligation not to allow its copyright to be used to the detriment of its licensees so that if Diamond was injured by Topps' conduct, even if that did not constitute an appropriation of Diamond's exclusive license, Diamond is entitled to the proportion of the settlement representing that injury. *Id.*

Therefore, the Eleventh Circuit Court of Appeals remanded the present action for this court to determine whether Diamond suffered injury as a result of Topps' conduct. *Id.* If the court finds that Diamond was injured, then Diamond is entitled to a proportion of the settlement regardless of whether Topps' conduct constituted an appropriation of Diamond's exclusive license rights. *Id.*

II. THE SCOPE OF THE LICENSE

The license agreement between OAA and Diamond, as already noted, provided that Diamond has "the exclusive license to utilize the name, character, symbol, design, likeness and visual representation" of Cabbage Patch Kids-The Little People from Babyland General "solely and only in connection with the manufacture, distribution and sale of the article or articles specified in Schedule 'B' hereto annexed."

Schedule "B" provides: Licensed products

1. Self Adhesive character and/or logo stickers as follows ACCESSORIES MAY BE INCLUDED THAT DO NOT CONFLICT WITH COLOR FORMS
   a. puffy vinyl stickers
   b. "Color-me" fuzzy stickers with accessory markers
   c. puffy, scratch 'n sniff stickers
   d. flat, scratch 'n sniff stickers on cards or rolls
2. Waxed-page sticker collection book
3. Waxed-page sticker baby book in book form

In determining whether Topps' appropriated Diamond's exclusive license the court must interpret the license agreement entered into between OAA and Diamond. "While the context of copyright law in which the agreement exists cannot be overlooked, application of Georgia rules to determine parties' contractual intent is not preempted by either copyright act nor does their appliation violate federal copyright policy." *Fantastic Fakes, Inc. v. Pickwick Intern., Inc.*, 661 F.2d 479, 483 (5th Cir. Unit B 1981). State law is

relied on to provide the cannon of contractual construction, but only to the extent such rules do not interfere with federal copyright law or policy. *S.O.S. Inc. v. Payday, Inc.*, 886 F.2d 1081, 1088 (9th Cir. 1989).

Georgia law provides some general rules of contract construction which are: promises in a contract should be construed as covenants rather than conditions if the text allows, terms of an agreement should be interpreted to avoid forfeiture of contract benefits, and all doubt as to the intended meaning of a contract should be resolved against the drafter. *Fantastic Fakes*, 661 F.2d at 484 (citations omitted).

Under Georgia law, the court first considers whether a contract is ambiguous. *Copy Systems of Savannah, Inc. v. Page*, 197 Ga. App. 435, 436 (1990). No construction of a contract is required when the language in the contract is plain, unambiguous, and capable of only one reasonable interpretation. *Smith v. Freeport Kaolin Co.*, 687 F.Supp. 1550, 1553 (M.D.Ga. 1988) (citation omitted). However, if an ambiguity exists, the court should try to resolve the ambiguity by applying Georgia rules of construction. *Id.* The cardinal rule of contract construction is to ascertain the intention of the parties. O.C.G.A. § 13-2-3.; *Southern Federal Savings & Loan Assoc. of Atlanta v. Lyle*, 249 Ga. 284, 287 (1989). "Where the contract terms are clear and unambiguous, the court will look to that alone to find the true intent of the parties (citations omitted) .... Where ... ambiguities exist, we may look outside the written terms of the contract and consider all the surrounding circumstances to determine the parties' intent." *Id.*

Thus, the court should interpret the contract as a matter of law and where necessary, construe it by applying

the rules of construction set forth in O.C.G.A. § 13-2-2. *Gans v. Ga. Fed. Sav. & Loan Assoc.*, 179 Ga. App. 660, 662 (1986) (citation omitted). "Where the language of an instrument may fairly be understood in more than one way, it should be interpreted to reflect the sense in which the parties understood it at the time of execution, and extrinsic evidence is admissible to establish what that original understanding was." *Id.* (citing *Nat'l Mfg. & Stores Corp. v. Dekle*, 48 Ga. App. 515 (1934)). The preferred meaning is that which will give effect to the contract as a whole. *Id.* In determining the intent of the parties, the whole instrument should be considered together with the surrounding circumstances. *Progressive Preferred Ins. v. Brown*, 261 Ga. 837 (1992) (citation omitted).

In this case, the court finds that the language of the contract demonstrates that the license agreement is an "item" license as that term has been used at trial. That is, the license agreement provided that Diamond is the exclusive licensee for the items specifically listed in the agreement.[2] The contract provides that the licensee shall have the exclusive license "solely and only in connectionwith the manufacture, distribution and sale of the article or articles specified in Schedule B." These are words of limitation and include only those items listed in Schedule B.

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[2] An "item" license has been distinguished from a "category" license. The later would, for example, give a licensee a license to manufacture and sell an entire product groups such as all stickers. The evidence at trial demonstrated that Diamond has entered into other agreements with licensors which gave Diamond an exclusive sticker category license. Those category licenses provided that the license was for "all stickers," employing more general and broad language than that used in the license involved in this case.

However, even if the court did conclude that the liense agreement was ambiguous, the surrounding circumstances demonstrate the parties' intent that the license agreement was an item license and not a category license. Ms. Tollhurst, the President of OAA testified that OAA only gave item licenses instead of category licenses and that the license at issue was clearly an item license that did not incude cards, bubble gum or Panini type stickers. Furthermore, the testimony of Ms. Tollhurst and the correspondence between Mr. Diamond and Schlaifer, Nance & Company (PX ##139, 140) indicate that Diamond received a license for the items he specifically proposed to Schlaifer, Nance & Company.

Although the court believes this evidence establishes the parties' intent to enter into an item license agreement, the testimony of Mr. Robinson, a licensing expert, adds force to plaintiff's argument that the license in question is an item license which lists products that did not extend to Panini type stickers or to bubble gum/trading card stickers. Specifically, Mr. Robinson testified that the license in question included those items listed and furthermore, did not include items in the other two product groups which were bubble gum/trading card stickers and Panini type stickers.[3] Mr. Stone also opined that the license in question does not extend to all stickers. The court's conclusion is also supported by the correspondence between Schlaifer, Nance & Company and Diamond with regard to a Panini product line in which Schlaifer, Nance & Company indicated that it would consider licensing Diamond in this category (Plaintiff's Exhibit #12). The fact that Diamond needed

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[3] Ms. Lichschtein also testified that there are three product areas in the sticker category which are trading cards, Panini stickers and the type of stickers listed in the license Diamond obtained from OAA.

permission to become a licensee of Panini type stickers indicates that the license was not a broad category license and was, instead, an item license.

Diamond argues that the subsequent course of dealing demonstrates that the parties' intent was to grant a category license.[4] Specifically, Diamond argues that the manufacture and approval of new items showed the original intent of the parties to enter into a category license. For example, Diamond introduced evidence that it manufactured items that it believes were not specifically listed in the license agreement but were approved of by OAA even tacitly, such as holographic stickers, paper stickers with a dispenser and tiny tiny paper stickers. Additionally, Diamond maintains that it obtained approval of these new items when they were on display and seen by OAA at the Toy Fair in New York.

The court disagrees with Diamond's conclusion. Some of the products Diamond relies on to support its position were arguably included in the description of items in the original license agreement. That is, the items that Diamond relies on in support of its argument are closely related to those items listed in the license agreement and there is no evidence that any oral modification was intended to include items in the other two product areas, Panini stickers and bubble gum/trading card stickers. To the extent that these products were not included in the license, any inference which can be drawn from this fact is far outweighed by other evidence of the parties' intent. Thus,

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[4] Because we reject this argument, the court need not address plaintiff's argument that 17 U.S.C. § 204(a) prohibits the transfer of copyright ownership unless it is in writing.

the subsequent course of dealing may have been, at most, an oral agreement to license new items but would not have changed the plain meaning of the original agreement from an item license to a category license.

Diamond also relies heavily on the statements made on behalf of OAA in the preliminary injunction hearing in the *Topps* case to support its arguments. The court notes that these are evidentiary admissions which must be weighed in context. That is, the proposed findings of fact and conclusions of law at the preliminary injunction stage were based on limited discovery and reflected positions taken by counsel at that time rather than facts supported by the evidence. According to Mr. Nodine, OAA's counsel in the *Topps* case, the findings of fact and conclusions of law demonstrated counsel's positions at the time, many of which were later abandoned based on further discovery and counsel's evaluation of evidence that could not be proven at trial. Thus, the testimony of Roger Schlaifer and the proposed findings of fact and conclusions of law at the preliminary injunction hearing must be given the weight the circumstances justify. The court notes that with regard to Mr. Schlaifer, the parties failed to call him as a witness in this case, and they did not refer to any deposition taken of Mr. Schlaifer in this case. Instead, the parties referred to Mr. Schlaifer's previous testimony in the transcript of the *Topps* preliminary injunction proceeding.[5]

Therefore, the court's interpretation of the license agreement indicates that it was not a license agreement for the entire sticker category, but was, instead,

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[5] There was also some indication that Mr. Schlaifer had been testifying without the agreement before him.

an item license specifically listing the items to be licensed. As a result, the license agreement did not include bubble gum/trading card type stickers and there was, therefore, no appropriation by Topps of Diamond's exclusive license.

III. LENGTH OF THE LICENSE

Although the court has already determined that there was no appropriation of Diamond's exclusive license rights, the court still must consider whether Diamond was injured as a result of Topps' conduct. In so doing, the court finds it relevant to consider how long the license was in existence.

The contract states:

> The licensed period is from February 1983 through January 1986. Licensor grants Licensee the option to extend the term of this license for one additional 12-month period, commencing immediately following expiration of the original license period, on all the same terms and conditions as herein contained (including "Advance" payable with exercise of such option), provided that (i) Licensee gives Licensor written notice of exercise of such option not later than six (6) months prior to the expiration of the preceding license period; and (ii) provided Licensee is not in default at such time; and (iii) provided that the minimum guarantee for the terms of the renewal is $15,000.00 . . . . . Guaranteed minimum compensation for one (1) year option period, if exercised in accordance with the terms set forth above, shall be $15,000 of which shall be payable on or before Feb. 1, 1986.

This language of the license agreement which pertains to the expiraton of the license agreement controls. Specifically, the court finds that the contract provision at issue sets forth three requirements for Diamond to meet before it could have extended the license for an additional year. These conditions are notice by the licensee, the licensee is not in default, and that the minimum guarantee for the option period be $15,000.

There is no dispute that Diamond gave notice of his intention to extend the license for the one year option period or that Diamond was not in default. Further, there is no question that Diamond paid at least $15,000 in guarantees. The question before the court, then, is whether Diamond had to pay the $15,000 minimum guarantee on or before February 1, 1986 for the license to be extended. The court concludes that it did not.

The court interprets this provision of the contract to provide that the minimum guarantee must be $15,000. However, the provision requiring that the guarantee be paid on or before Feburary 1, 1986 was a covenant or an obligation, not a condition. Once the contract was extended, failure to pay was a breach which required notice of termination on the part of OAA. OAA gave no notice of termination and thus, the license was in effect until January 1, 1987.

Diamond's March, 1986 letter to OAA is consistent with the court's interpretation of the contract provision. Furthermore, OAA's response to Diamond's letter was ambiguous and was not a notice of termination. Additionally, both parties treated the agreement as if it had been extended[6], and Diamond included royalty payments to OAA

[6] For example, Diamond showed new products at Toy Fair in New York during February, 1986.

through January, 1987 and for the additional ninety day sell off period as the contract provided.

Therefore, the court concludes that the license was extended, and expired in January, 1987.

IV. INJURY TO DIAMOND FROM TOPPS' CONDUCT

Because the court has found that the license agreement at issue did not include the type of cards manufactured by Topps, Topps did not appropriate Diamond's exclusive license. The next question, then, is whether Diamond has demonstrated that it was injured as a result of Topps' conduct and is therefore equitably entitled to a proportion of the settlement representing those injuries.

Diamond failed to carry its burden of showing any injury as a result of Topps' conduct. The court finds that there was no direct competition between Topps' Garbage Pail Kids stickers and Diamond's Cabbage Patch stickers, and no demonstrable injury to Diamond. This conclusion is supported by the evidence introduced at trial.

For example, Mr. Tom Prichard testified that there was no competition between the products, which are sold in different departments and to different groups of consumers. Additionally, Ms. Betsy Lichschtein of Panini stickers testified that puffy vinyl stickers did not compete with trading cards, and soft images such as Cabbage Patch Kids appeal to younger girls and hard images such as Garbage Pail Kids appeal to older boys. Moreover, Mr. Robinson testified that Garbage Pail Kids are trading cards that are collected and do not compete with puffy vinyl stickers because they have different channels of trade,

different prices, and different end uses. Mr. Robinson also testified that the Garbage Pail Kids was a parody affecting all Cabbage Patch Kids sales, not just one licensee and was really a parody on the Cabbage Patch Kids, not on Cabbage Patch Kids' stickers. Additionally, Mr. Stone testified that the commercial appeal of the Cabbage Patch product was not the same as the commercial appeal of the Garbage Pail product.

Much confusion in this case stems from the original depositions and positions of counsel taken by OAA in the *Topps* case. During the *Topps* preliminary injunction hearing, counsel for OAA took the position that it was entitled to recovery as a result of direct competition. The arguments of counsel during the preliminary stages of the *Topps* case were taken for purposes of advocacy and, as Mr. Nodine testified in this case, OAA was unable to support this position with evidence. Although Mr. Nodine admits that he received an affidavit of Mr. Eber of Hallmark for the *Topps* case to the effect that the stickers competed, this was the only evidence of competition between Garbage Pail Kids and puffy vinyl stickers that OAA had in that case. Mr. Nodine testified during this trial that as a result of this lack of evidence of direct competition OAA changed the trial strategy in the *Topps* case to represent the damage that the Garbage Pail Kids had on OAA's good will and the Cabbage Patch Kids' image. Thus, Mr. Nodine testified that OAA's position at the preliminary stages of the *Topps* case became untenable, and the emphasis of the *Topps* litigation was changed to focus on the damage to OAA's good will. The great weight of the evidence at this trial has shown that there was no direct competition.

Furthermore, Mr. Prichard testified that Garbage Pail Kids had no impact on Cabbage Patch stickers because

at the time, there was no sticker business left at Walmart. Ms. Tollhurst also testified that there could be no competition or injury to Diamond because Garbage Pail Kids took off in the second quarter of 1985 and Diamond sales dropped in the first quarter of 1984 and fell more significantly by the fourth quarter of 1984. Mr. Robinson, a very credible witness, also testified that by the end of 1985 there was no puffy vinyl sticker market. Furthermore, Mr. Nodine testified that Mr. Moracass, the former Vice President of Operations at Diamond, told Mr. Nodine right before the trial in the *Topps* case that there were no Diamond Cabbage Patch Kid sticker sales hurt by Garbage Pail Kids because there was no market for puffy vinyl stickers and, regardless, the products were in different markets. In fact, even Mr. Diamond admitted in a letter to Roger Schlaifer that the sticker category is a thing of the past (PX #2). Mr. Stone, also testified that puffy vinyl sticker sales went down in 1984 and 1985. Thus, there was sufficient evidence presented at trial that there was no market for Diamond Cabbage Patch stickers at the time Garbage Pail Kids' stickers became popular, and thus, there was no injury to Diamond as a result of Topps' conduct.

Additionally, the statistical evidence presented at trial supports the finding that there was no injury to Diamond. For example, Mr. John Fidley conducted a study of National Latex, the only company that manufactured products for both Cabbage Patch Kids and Garbage Pail Kids, in which he concluded that there was no correlation between a decrease in sales of Cabbage Patch Kids and an increase in sales of Garbage Pail Kids. Additionally, Ms. Tollhurst testified about a Gallup Poll that was taken for the *Topps* case which questioned OAA's theory that Garbage Pail Kids had an impact on Cabbage Patch Kids sales (PX #93, p.21).

Therefore, Diamond has shown no injury as a result of Topps' conduct. As a result, the court concludes as a matter of law that Diamond is not entitled to a proportion of the settlement. The court recognizes that OAA had a fiduciary duty to prevent injury to Diamond. However, the court finds that there was no breach of that duty in the manner in which OAA sought to protect Diamonds's rights, as for example, in OAA's decision to request an expedited trial instead of posting a bond to give force to the preliminary injunction.

The court is aware of the language quoted by the Eleventh Circuit Court of Appeals with regard to OAA's fiduciary duty. The court finds that the following language is relevant: "[t]here is implied a negative covenant on the part of the [grantor] ... not to use the ungranted portion of the copyright estate to the detriment, if not the destruction, of the licensees' estate." *Original Appalachian Artworks*, 911 F.2d at 1551 (quoting *Manners v. Morosco*, 252 U.S. 317, 327 (1920), quoting *Harper Bros. v. Klaw*, 230 F. 609, 613 (S.D.N.Y. 1916)). This fiduciary duty required OAA to hold in trust that part of the settlement that constituted injury to Diamond as a result of Topps' conduct. Although it is clear that as part of its fiduciary duty OAA must remit that part of the settlement which constitutes actual injury to Diamond as a result of Topps' conduct, Diamond has failed to demonstrate that it suffered any legally cognizable injury as a result of Topps' conduct.[7] Accordingly, Diamond is not entitled to recover under the second theory enunciated in *McClintic v. Sheldon*, 269 A.D. 356, N.Y.S. 2d 879, 882 (N.Y. App. Div. 1945), *aff'd*, 295 N.Y. 682, 65 N.E. 2d 328 (1946),

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[7] The court also notes that even if Diamond had proved injury, it offered no method to quantify that injury or to determine what proportion of the settlement was attributable to that injury.

as interpreted and applied by the Eleventh Circuit Court of Appeals.

In support of its position, Diamond claimed that evidence of injury as a result of Topps' conduct is shown by the fact that Diamond could not manufacture Panini type stickers of the Cabbage Patch Kids. However, there was ample evidence at trial, including the testimony of Ms. Tollhurst and Ms. Lichschtein, that the existence of Garbage Pail Kids stickers had nothing to do with the fact that Diamond did not manufacture Panini type stickers. Diamond's best argument with regard to injury, however, is its assertion that there are a limited number of dollars that could be spent on stickers. With additional products in the market, such as Garbage Pail Kids, less money is available to spend on Diamond's Cabbage Patch Kids' stickers, resulting in injury to Diamond. However, this argument is too speculative to constitute grounds on which Diamond could recover for injury as a result of Topps' conduct and it is therefore rejected.

V. CONCLUSION

The court concludes that Topps did not appropriate Diamond's exclusive license and Diamond has not been injured as a result of Topps' conduct. Therefore, Diamond is not entitled to a proportion of the settlement agreement entered into between OAA and Topps.

SO ORDERED, this 29th day of July, 1993.

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JACK T. CAMP
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES COURT OF APPEALS,
ELEVENTH CIRCUIT

No. 89-8368

ORIGINAL APPALACHIAN ARTWORKS, INC., a Georgia Corporation,

Plaintiff-Counterclaim Defendant-Appellee,

versus

S. DIAMOND ASSOCIATES, INC., an Illinois Corporation,

Defendant-Counterclaim Plaintiff-Appellant.

Appeal from the United States District Court for the Northern District of Georgia

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(Sept. 18, 1990)

Before TJOFLAT, Chief Judge, TUTTLE, and RONEY*, Senior Circuit Judges.

TJOFLAT, Chief Judge:

The defendant in this declatory judgment action appeals the district court's grant of summary judgment for the plaintiff. The defendant, an exclusive licensee of the plaintiff's, contends that the district court erred in holding that the defendant had no right to a proportion of the plaintiff's settlement in a lawsuit against a third

party for copyright infringement. We agree with the defendant. Accordingly, we reverse the district court's decision and remand for further proceedings.

I.

Since 1979, Original Appalachian Artworks, Inc. (OAA) has owned the copyright and trademark for the Cabbage Patch Kids. In 1982, OAA began a licensing program that allowed companies to use the Cabbage Patch Kids name and characters in association with a variety of products, including dolls, books, records, cereals, and children's clothing, shoes, and linens. As its exclusive licensing agent, OAA employed Schlaifer, Nance & Company.

In February 1983, OAA (through its licensing agent) entered into a licensing agreement with S. Diamond Associates (Diamond).[1] The agreement gave Diamond "the exclusive license to utilize the name, character, symbol, design, likeness and visual representation" of the Cabbage Patch Kids "solely and only in connection with the manufacture, distribution and sale" of a puffy sticker product. In exchange for those rights, Diamond agreed to pay OAA $45,000 and ten percent of its sales revenues. OAA expressly retained the right to any goodwill associated with the Cabbage Patch name. In addition, OAA reserved "the sole right to determine whether or not any

[1] Because Schlaifer, Nance & Company had authority to act as OAA's agent in granting licenses to the third parties, and because that authority was disclosed in the licensing agreement with Diamond, we treat the agreement between Diamond and Schlaifer, Nance as a contract between Diamond and OAA. *See* F. Mechem, Outlines of the Law of Agency 296 (4th ed. 1952) (when agent has authority to bind the principal, and principal is disclosed, the contract is the principal's "contract as much as if he had executed it in person").

action shall be taken on account of any infringements or limitations [of the licensed marks]." The agreement thus proscribed Diamond from taking such action "without first obtaining the written consent of [OAA] to do so."

In 1985, Topps Chewing Gum, Inc. (Topps) began to market a product called Garbage Pail Kids. The product consisted of a package containing sticker cards with images of characters that were strikingly similar to the Cabbage Patch Kids, but depicted in less than flattering situations. For example, the sticker showed one Garbage Pail Kid, Graffiti Petey, painting graffiti on a wall; another Garbage Pail Kid, Adam Bomb, has just blown himself up.[2] In 1986, Topps also began a licensing program for Garbage Pail Kids products such as T-shirts, school supplies, and balloons. Topps had previously discussed the possibility of a licensing arrangement with OAA but had never entered into one.

In March 1986, OAA brought suit in the district court against Topps for copyright infringement, trademark infringement, and unfair competition. In August 1986, the district court granted OAA a preliminary injunction enjoining Topps from selling the Garbage Pail Kids stickers. *See Original Appalachian Artworks, Inc. v. Topps Chewing Gum, Inc.*, 642 F.Supp.1031 (N.D.Ga.1986). On February 2, 1987, OAA and Topps entered into a settlement agreement: Topps agreed to pay OAA $7,000,000; in return OAA agreed not to sue Topps and not to authorized any of its licensees to sue Topps for any copyright or trademark infringement

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[2] At oral argument before this court, counsel for OAA compared a Cabbage Patch sticker with a Garbage Pail sticker: he described the Cabbage Patch Kid as "this absolutely adorable little child coming out of the proverbial cabbages: you just want to pick her up, hold her, and hug her to death"; he then described the Garbage Pail Kid as "a child covered in, and dripping in, ...snot."

related to Topps' Garbage Pail Kids.

On February 4, 1987, after learning of the settlement agreement, Diamond moved to intervene before the court dismissed the case. Diamond contended that it had suffered injury as a result of Topps' infringing conduct and sought injunctive relief and damages. To that end, Diamond requested an accounting to determine how much Topps owed OAA and Diamond. The district court denied Diamond's motion.

OAA then brought the present diversity jurisdiction action against Diamond in the district court. OAA sought a declaratory judgment pursuant to 28 U.S.C. §§ 2201, 2202 (1988) that Diamond had no interest in the proceeds of the settlement agreement. Diamond counterclaimed, contending that it had suffered substantial economic injury from the marketing of the Garbage Pail stickers and that OAA had a duty, under the licensing agreement, to protect Diamond's interests as a licensee. Diamond thus requested the court to impose a constructive or resulting trust, or an equitable lien, on the settlement proceeds and also requested an accounting to determine the proportion of the proceeds to which Diamond was entitled.[3]

After a period of discovery, both parties moved for summary judgment. In a March 1989 order, the district court granted summary judgment for OAA. The district

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[3] Diamond also claimed that OAA's refusal to pay Diamond a proportion of the settlement constituted a violation of the Georgia tort law prohibiting interference with property rights. *See* Ga.Code Ann. § 51-9-1 (1982). The district court did not decide this claim, and we therefore decline to consider it. We note in passing that the relief prayed for in this claim is the same as the relief we describe in the text.

court held that Diamond had no right, pursuant to the licensing agreement, to compensation when OAA recovered from an infringer. In the court's view, Diamond relinquished any such right since OAA retained the exclusive right to "institute suit or take any action on account of any infringements or imitations." The court acknowledged that this provision gave rise to a fiduciary obligation on OAA's part "to protect Diamond's exclusive licensed rights," but the court held that this fiduciary obligation "does not require that OAA equitably compensate Diamond where the OAA recovers for the unauthorized appropriation of Diamond's rights." Thus although OAA must presumably take action to prevent infringement, OAA has no obligation to compensate Diamond if OAA recovers for any injury suffered by Diamond as a result of the infrigement.

In addition to its contract interpretation, the district court supported its decision by finding that OAA's settlement with Topps constituted a recovery solely for the damage that the Garbage Pail Kids caused to the goodwill associated with the Cabbage Patch name, OAA's recovery, according to the court, did not reflect any decrease in licensing fees associated with decrease in Diamond's revenues as a result of the marketing of the Garbage Pail Kids. As the court observed, OAA expressly retained the right to that goodwill in the licensing agreement. Based on those conclusions, the district court determined, pursuant to Fed.R.Civ.P. 56(c), that no genuine issue of material fact existed and that OAA was entitled to summary judgment as a matter of law.

On appeal, Diamond argues that the district court erred, as a matter of law, in holding that the licensing agreement prevented Diamond from recovering the proportion of the Topps' settlement reflecting the injuries

Diamond suffered as a result of Topps' infringing conduct. Based on the error, Diamond contends, the district court also erred in holding that OAA had no fiduciary duty to pay Diamond a proportion of the settlement. We agree, and accordingly reverse the district court's grant of summary judgment and remand the case for further proceedings.

II

The district court properly acknowledged that "OAA was under implied good faith obligation not to do anything that would impair or destroy the value of an exclusive licensee's rights." (Citing *Kirle La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 188 N.E. 163 (1933); *Zim v. Western Publishing Co.*, 573 F.2d 1318 (5th Cir.1978); 3 Nimmer on Copyright § 10.11[A], at 10-94 (1987)). The court, however, held that this obligation did not require OAA to share the Topps' settlement proceeds with Diamond. In so concluding, the district court distinguished *McClintic v. Sheldon*, 269 A.D. 356, 360-61, 55 N.Y.S.2d 879, 882 (N.Y. App.Div.1945). *aff'd*, 295 N.Y. 682, 65 N.E.2d 328 (1946), a case on which Diamond relied. We first analyze the *McClintic* case and then consider the extent of OAA's good faith obligation.

In *McClintic*, the defendants, who had authored a play, granted McClintic the exclusive right to present the play. Pursuant to the agreement, the plaintiff received an interest in all profits derived from the play, including fifty percent of all profits from the sale or disposition of motion picture rights. The authors expressly retained all rights, title, and interest in the play's copyright. Metro-Goldwyn-Mayer Corp. (MGM) subsequently attempted to acquire the movie rights from the authors, but the negotiations failed. MGM nevertheless produced a movie that rather closely

resembled the play. In fact, the movie so closely resembled the play that the authors sued MGM for copyright infringement and won. McClintic, however, asserted a right to fifty percent of the authors' recovery. The authors refused to pay, and McClintic brought suit. The trial court denied the plaintiff recovery, holding that the defendants had recovered against MGM solely "for damages for the unauthorized appropriation of defendants' copyright and not of the motion picture rights granted to plaintiff," 55 N.Y.S.2d at 880. The supreme court, appellate division, however, reversed.

The supreme court held that, although the defendants' recovery in their suit against MGM "represented damages for infringement of [their] copyright in the play, it also constituted damages for the appropriated motion picture rights." *Id.* at 882. Pursuant to the licensing agreement, the plaintiff had a right to fifty percent of the profits derived from any disposition of the motion picture rights. As the *McClintic* court explained:

It is not disputed that if the license to make a motion picture of the play had been sold to the Metro-Goldwyn-Mayer Corp., the plaintiff would have received 50% of the sales price. Where, as here, the rights were not purchased but were improperly appropriated and defendants have recovered for that conversion, plaintiff is not to be deprived of his interest in the recovery. By paying over the apportioned profits from the motion picture which was adjudged to be an infringement upon the copyright of the play ..., the Metro-Goldwyn company merely consummated an involuntary sale of a license to produce a motion picture of the play. Within the clear language of his agreement with defendants, plaintiff was a half owner of such fund.

Id. 55 N.Y.S.2d at 882.

In addition, the McClintic court explained that, even if the plaintiff did not an interest in profits from the movie rights, the plaintiff had an equitable interest in the defendants' copyright--all right, title, and interest to which the defendants had expressly retained. Citing *Kirke La Shelle,* the supreme court stated that the "[d]efendants here were trustees of the copyright for the benefit of both themselves and plaintiff, and defendants may not, in justice, retain all the proceeds received by them as compensation for an unauthorized appropriation of the play which is owned in part by plaintiff." *Id.*

The *McClintic* court thus held, under two theories, that the plaintiff had a right to a portion of the defendants' recovery. First, the defendants' recovery constituted damages for the appropriated motion picture rights, in which the plaintiff owned a fifty percent interest under the licensing agreement. Second, notwithstanding the plaintiff's interest in the movie rights, the defendants also had a fiduciary duty that prevented them from retaining the entire recovery for MGM's unauthorized appropriation of the play itself. As other courts have similarly held, "[t]here is implied a negative covenant on the part of [grantor]...not to use the ungranted portion of the copyright estate to the detriment, if not the destruction, of the licensees' estate." *Manners v. Morosco,* 252 U.S. 317, 327, 40 S.Ct. 335, 336, 64 L.Ed. 590 (1920) (quoting *Harper Bros. v. Klaw,* 232 F. 609, 613 (S.D.N.Y.1916)).

Applying this rationale to the present case, Diamond has two possible grounds for recovery of a proportion of the settlement. Under *McClintic's* first rationale, Diamond is entitled to the proportion of the settlement that represents

damages for Topps' appropriation of Diamond's exclusive license. As with the movie rights at issue in *McClintic*, Diamond's licensing agreement expressly gave it the exclusive right to manufacture Cabbage Patch stickers. If, in marketing its Garbage Pail Kids stickers, Topps appropriated Diamond's exclusive license to manufacture stickers, then Diamond is entitled to the proportion of the settlement representing that appropriation. Under *McClintic's* second rationale Diamond is entitled to the proportion of the settlement representing Diamond's injuries as a result of Topps' sales, even if that injury did not relate to a right that the licensing agreement expressly granted to Diamond. OAA has a fiduciary obligation not to allow its own copyright to be used to the detriment of its licensees. Thus, if Diamond was injured by Topps' conduct--even if that conduct did not constitute an appropriation of Diamond's exclusive licence-Diamond is entitled to the proportion of the settlement representing that injury. The present case, therefore, turns on a single issue: did Diamond suffer injury as a result of Topps' conduct? If so, Diamond is entitled to a proportion of the settlement whether or not Topps' conduct constituted an appropriation of Diamond's exclusive license.

The district court did not reach this question. Rather, the court attempted to distinguish *McClintic* on the ground that the agreement in *McClintic "expressly* gave the plaintiff/licensee the right to one-half of the proceeds in the event the playwright sold the play for use as a motion picture." According to the court, the licensing agreement here contained no such provision. We disagree. The agreement expressly gave Diamond an exclusive right to make stickers. Topps' stickers might well have constituted an appropriation of that exclusive right. As we explain, moreover, if Diamond was injured by Topps' conduct, it

has a right to a proportion of the settlement whether or not the injury involved an actual appropriation of its exclusive license.

As this discussion demonstrates, the district court could not have granted summary judgment on the ground that Diamond had no right, pursuant to the licensing agreement, to recover a proportion of the settlement. The district court could have granted summary judgment only if it concluded that no genuine issue of material fact existed on the issue of injury--i.e., if, drawing from the record all inferences favorable to Diamond, it was apparent that Diamond suffered no injury as a result of Topps' conduct. The district court clearly did not consider this question. Nonetheless, because we are bound to uphold the disposition below if an alternate ground supports it, we consider whether the district court could properly have granted summary judgment on that basis.

We conclude that the district court could not have done so. In bringing its infringement action against Topps, OAA heavily relied on the injury suffered by Diamond to support its claim for injunctive relief and damages. For example, OAA's proposed findings of fact and conclusions of law in the *Topps* case emphasizes throughout that the Topps stickers directly competed with Diamond's stickers.[4] As the transcript of the preliminary injunction hearing also demonstrate, OAA based its case in large part

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[4] Paragraph 36 of its proposed findings of law stated: "The Diamond license was exclusive and precluded licensing Topps for the stickers..." Paragraphs 38 and 39 stated: "Berger [the Topps representative] attempted to convince Roger Schlaifer [OAA's licensing agent] that the Topps' stickers would not compete with Diamond's stickers..."

on the similarity between the Topps and the Diamond stickers.[5] Additionally, OAA had begun to prepare

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because Topps' stickers were less expensive and Topps' distribution was totaly different.... Mr. Schlaifer was not persuaded by Mr. Berger's arguments, and Topps was not granted a license."

Paragraph 114 stated: "The GARBAGE PAIL KIDS licensing program is in direct competition with the CABBAGE PATCH KIDS licensing programs." More specifically, paragraph 144 stated: "The GARBAGE PAIL KIDS stickers are directly competitive with Diamond's present Puffy Stick-Ons and it is likely that GARBAGE PAIL KIDS sales will cut into CABBAGE PATCH KIDS sales." Paragraph 145 continued: "In its own GARBAGE PAIL KIDS licensing program, Topps recognized that puffy stickers would compete with paper stickers when it refused product approval for Imperial Toys' vinyl puffy stickers because it would conflict with Warner Books' license for paper sticker albums."

In its proposed conclusions of law, OAA stated in paragraph 33: "OAA has proved that the GARBAGE PAIL KIDS stickers will have a negative impact upon the potential market for a value of the copyrighted work.... [P]laintiff has shown direct and actual competition between its CABBAGE PATCH KIDS stickers, manufactured and sold under license to Diamond Toys and the GARBAGE PAIL KIDS stickers.... Topps was repeatedly denied a CABBAGE PATCH KIDS license for stickers because it would compete with Diamond's exclusive license. Paragraph 55 reiterated: "Topps GARBAGE PAIL KIDS stickers are directly, competitive with Diamond's CABBAGE PATCH KIDS puffy Stick-Ons.

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[5] OAA, in its opening statement, declared: "We will show the similarity of the Garbage Pail Kids stickers with the similarity of the products of the Cabbage Patch Kids stickers. That's a licensed product by Diamond Toys.... We will also show the similarity of the products ... by the testimony... of Mr. Schlaifer [OAA's licensing agent] who will show direct competition in the marketplace."

At the hearing, OAA did what it promised. As Schlaifer: "Diamond's initial license covered all self-adhesive stickers and sticker by-products...." He indicated that the Diamond license would have prevented OAA from licensing Topps to produce its stickers. OAA also presented the testimony of the product manager of Hallmark Cards, who was responsible for juvenile stickers, that the two products were in direct competition.

OAA then reemphasized in its closing argument that it had "shown direct competition between Garbage Pail and Cabbage Patch Kids in stickers, for instance."

Diamond's owner to testify at trial in the *Topps* case regarding the company's injuries. In effect, therefore OAA has conceded that Diamond suffered injury as a result of the direct competition between Topps' stickers and Diamond's own stickers. At the very least that concession raises a genuine issue of material fact.

III.

For the foregoing reasons, we conclude that the district court erred in granting summary judgment for OAA. Pursuant to the licensing agreement, Diamond has a right to recover the proportion of OAA's settlement agreement with Topps that represents injury suffered by Diamond from marketing of the Garbage Pail Kids. OAA, moreover, has a fiduciary duty to pay Diamond that proportion of the settlement whether or not Topps' conduct constituted an appropriation of Diamond's exclusive license. The case thus turns on the issue whether, and to what extent, Diamond suffered injury as a result of Topps' conduct. That question, however, presents a genuine issue of material fact.

Accordingly, the district court's decision is VACATED and the case is REMANDED for further proceedings consistent with this decision.

IT IS SO ORDERED.